
Depositor Reaction to Increased Risk at Banks Session: Discussion

FDIC Conference
September 2018
Richard Rosen
Federal Reserve Bank of Chicago

The views expressed here are not necessarily those of the Federal Reserve Bank
of Chicago or the Federal Reserve System.



Overview

- **These two papers address the reaction to bad news about a bank.**
- **They address different ways news about risk can be spread.**
 - “Paying Attention to Banks: Evidence from Offshore Deposits” asks what news is.
 - ◆ Compares  searches to newspaper articles.
 - “Deposit Inflows and Outflows in Failing Banks: The Role of Deposit Insurance” focuses on formal (public) enforcement actions.

Overview

- **The papers address two important questions:**
 1. Do depositors discipline banks?
 2. How sticky are bank deposits?
- **Both papers provide evidence that bad news about a bank changes how depositors act in interesting ways.**
 - Find results that might not be expected on the surface.
- **They show the need to think through how depositors (and banks) react to information about riskiness.**

Paying Attention to Banks: Evidence from Offshore Deposits

.

Paying Attention to Banks: Evidence from Offshore Deposits

- **This paper shows P.T. Barnum was wrong**
 - He (allegedly) said, “I don't care what the newspapers say about me as long as they spell my name right.”
- **Attention (Google search) is bad for a bank.**
 - Deposits ↓
 - Deposit rate ↑
- **True even for insured deposits.**
- **Interpretation: If you're worried enough to search, you're worried enough to run (or at least require a larger interest rate).**

Paying Attention to Banks: Evidence from Offshore Deposits

- **Compare across two regimes with the same banks but different deposit insurance systems.**
 - U.K. (traditional deposit insurance) vs. British Crown Dependencies (weaker coverage implemented only after the financial crisis).
- **Effect of attention on deposit rates is stronger for offshore banks.**
 - The “power increases with the credibility of [deposit] insurance.”

Paying Attention to Banks: Evidence from Offshore Deposits

Discussion

- 1. Negative newspaper articles don't matter (fake news?).**
- 2. Results driven by the financial crisis?**

Paying Attention to Banks: Evidence from Offshore Deposits

Discussion 1: Negative newspaper articles don't matter.

Table 5 DEPOSIT RATES AND BANK RISK

	(4)
<i>Dependent variable:</i>	
Capitalisation _{i,t}	2.27*** (0.75)
Stable Funding _{i,t}	-0.45 (0.46)
CDS _{i,t}	
Attention _{i,t}	0.05*** (0.02)
News _{i,t}	-0.08 (0.06)

News and interaction terms also not significant in Table 6

- Does count of articles work better (mentioned but not shown)?
- Is there a threshold effect for news?

Paying Attention to Banks: Evidence from Offshore Deposits

Discussion 2: Results driven by the financial crisis?

Searches for 2 UK banks from 2007-2009



Paying Attention to Banks: Evidence from Offshore Deposits

Discussion 2: Results driven by the financial crisis?

Longer view of searches for HSBC and Barclays: 2004-2018



Paying Attention to Banks: Evidence from Offshore Deposits

Discussion 2: Results driven by the financial crisis?

- **When sample is split into 1/2007-10/2008 and 11/2008-8/2015, attention has no significant effect in latter period.**
 - I suspect the difference may be due to financial crisis, not increase in DI in October 2008.

Deposit Inflows and Outflows in Failing Banks: The Role of Deposit Insurance

Deposit Inflows and Outflows in Failing Banks: The Role of Deposit Insurance

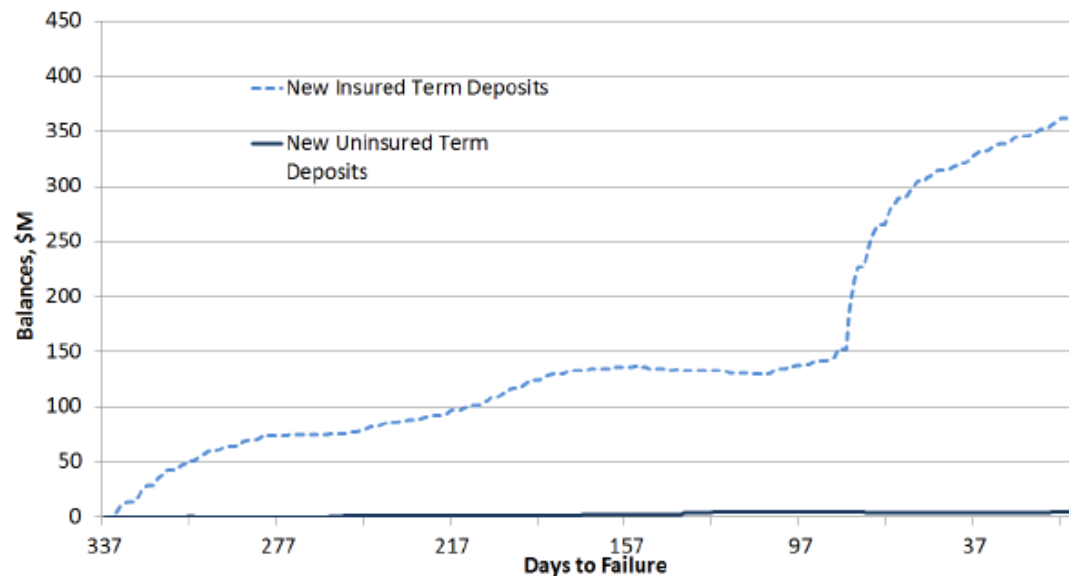
- **Depositors flee weak banks, especially uninsured depositors.**
 - Who else leaves: exactly who you would expect.
 - ◆ More active, larger accounts, without direct deposits, corporations (vs. individuals).

- **But, others rush in: listing service deposits from institutional clients.**

Deposit Inflows and Outflows in Failing Banks: The Role of Deposit Insurance

- **Authors examine one ~\$2 billion bank in detail.**
 - “Run out” of about 1/3 of deposits when bank was under enforcement action
 - But net outflow was small because of “run in” of institutional insured deposits

Figure 3: Term Deposit Balances From New Depositors



Balances in term deposit accounts from depositors who opened their first deposit account with the bank after the formal enforcement action — new depositors.

Deposit Inflows and Outflows in Failing Banks: The Role of Deposit Insurance

Discussion

- 1. Are depositors leaving because bank may fail or because of general bad news (as in the prior paper)?**
- 2. Is inflow of deposits necessarily a bad thing?**
- 3. What do the results tell us about liquidity regulation?**

Deposit Inflows and Outflows in Failing Banks: The Role of Deposit Insurance

Discussion 1: Are depositors leaving because bank may fail or because of general bad news (as in the prior paper)?

	Pre-crisis	Enforcement period
	<i>Cox P.H.</i>	<i>Cox P.H.</i>
	(1)	(1)
Uninsured	1.067	1.919***
	(1.53)	(10.00)
Checking & Uninsured	1.152	0.844
↔ <i>Later Covered by TAG/DFA</i>	(1.36)	(-1.11)
Checking	0.591***	0.805***
	(-10.43)	(-4.38)
Direct Deposit	0.647***	0.735***
	(-7.14)	(-3.87)
Log(Age)	0.986	0.936***
	(-1.05)	(-3.11)
Prior Transactions	1.053***	1.013***
	(18.95)	(3.95)
Prior Transactions ²	0.999***	1.000***
	(-15.30)	(-4.77)
Institutional - Any	1.076	0.997
	(0.88)	(-0.04)
Trust	1.014	1.169**
	(0.13)	(2.11)

Deposit Inflows and Outflows in Failing Banks: The Role of Deposit Insurance

Discussion 1: Are depositors leaving because bank may fail or because of general bad news (as in the prior paper)?

- **Run out generally similar to pre-crisis period where there was stress for financial system but not the bank.**
 - Do depositors react differently to generalized bad news about banks than to specific bad news about their bank?

Deposit Inflows and Outflows in Failing Banks: The Role of Deposit Insurance

Discussion 2: Is the inflow of deposits necessarily a bad thing?

- **Authors suggest that their results imply** “depositor discipline was ineffective in restraining bank risk-taking.”
- **But without large deposit outflow, the bank would likely have to liquidate assets.**
 - Can convert a liquidity issue into a solvency issue.
 - Is the bank making *new* loans during enforcement period?
- **Does ability to get deposits when weak affect depositors’ or borrowers’ decisions to use bank before the enforcement action?**

Deposit Inflows and Outflows in Failing Banks: The Role of Deposit Insurance

Discussion 3: What do the results tell us about liquidity regulation?

- **Ability to separate run off from net change in deposits is important in evaluating liquidity risk.**
 - Bank comes close to but generally does not breach LCR run-off assumption.
 - Does breach NSFR assumption in crisis and in enforcement period.
- **Suggests need to do similar test for other banks.**
- **Further shows similarity of pre-crisis and enforcement period.**
 - What would occur at a *troubled bank* during a *crisis*?

Concluding comments

- **The papers add to our knowledge of how banks respond to information about their riskiness.**
- **Depositors discipline banks to an extent, but discipline might not work as well as we would like.**
 - Some run from bank when it gets riskier while other require higher deposit interest rates.
 - ◆ But depositors may not act until bad news gets their attention.
 - ◆ And higher rates may attract new depositors.
 - Especially sophisticated depositors.
- **You should run to read both of these papers.**

Thank you

